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## **ASIA-PACIFIC ECONOMIC SURVEYS: HONG KONG**

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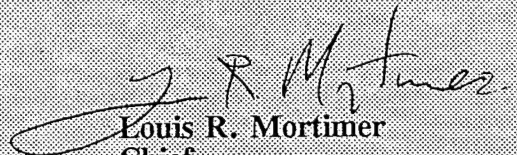
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## ASIA-PACIFIC ECONOMIC SURVEYS: HONG KONG

### SUMMARY STATEMENT

Hong Kong, with a population of 5.7 million people and a gross domestic product (GDP) of US\$37.21 billion (in 1986), is a trading center whose economic performance depends largely on world trade conditions. It is a major financial services center and a significant exporter of textiles and light industrial goods. In 1986 Hong Kong's GDP increased by 8.7 percent, and its exports rose by nearly 10 percent. A fundamental factor in Hong Kong's economic performance is the fixed exchange rate between the Hong Kong dollar and the US dollar. As the US dollar declined in 1986, Hong Kong's exports became more competitive, and sales to Western Europe increased. The weakened currency, however, brought threats of renewed inflation and an adverse balance of trade for 1987. For the immediate future, Hong Kong should profit from its improved trade with China, and its increased economic integration with China's booming Pearl River (Zhujiang) Delta. Hong Kong is dependent on exports of a few types of commodities to a few major markets and, thus, is very vulnerable to protectionist measures in the United States, its major export market. Decisions of the governments of China, the United States, and Japan (Hong Kong's major trade partners and foreign investors) on such matters as trade barriers, import quotas, and currency exchange rates will have a greater effect on Hong Kong's economy than those of the Hong Kong government, which deliberately does not intervene in the economy except in emergencies.

### EXPORT-LED GROWTH IN 1986

During 1986 Hong Kong's GDP grew by 8.7 percent, after increasing by only .8 percent in 1985. The large increase in the GDP was caused in great part by a surge of exports, which increased by nearly 10 percent. The primary factor in the growth of exports was the declining value of the Hong Kong dollar, which has been directly linked to the US dollar since 1983. The fall of the US dollar thus made Hong Kong's exports more competitive in 1986, but brought threats of further inflation and higher costs for necessary imports in 1987. It is unlikely, therefore, that GDP growth in 1987 will match that of 1986.

### GOVERNMENT BUDGET SURPLUS IN 1986

Hong Kong's government traditionally has followed a hands-off policy toward the free-market economy. Hong Kong is a free port with a low and simple tax structure. The government provides roads and such public utilities as water, sewage, low and medium-income housing, mass transit, public health, and free or subsidized education through university for its citizens. It provides public order and courts to enforce contracts, and exercises its extensive powers over land use to provide capital-intensive and high-technology industries with land at concessionary rates.

Beyond these measures, the government leaves economic decisions to the market. The Hong Kong Government's primary fiscal policy links the Hong Kong dollar to the US dollar at a fixed exchange rate of US\$1=HK\$7.80. It is difficult for the Hong Kong Government to predict its annual revenues, because economic activity depends so much on world trade conditions. However, the government traditionally has tried to operate with a budgetary surplus, which goes into a reserve fund. During 1986 the government limited expenditures, attempting to keep its spending at 16 percent of the GDP. It finished the year with a surplus of US\$384 million, which was considerably more than the expected surplus of US\$45 million.

#### SMALL TRADE SURPLUS

Although offset by a surplus from the sale of services, Hong Kong traditionally runs a merchandise trade deficit, largely because it must import food and energy supplies. Hong Kong's government has no foreign debt. In 1986 Hong Kong had a current account surplus of about US\$2 billion. It also suffered a growing trade deficit with Japan and a large capital outflow as wealthy businessmen, apprehensive about reversion to China in 1997, shifted assets to the United States, Canada, and Australia.

#### SERVICES PREDOMINATE OVER MANUFACTURING

Hong Kong is the world's third largest financial center and the world's second port in terms of tonnage. Services, including import and export trade, finance, transportation, and insurance, made up 46 percent of the GDP in 1984 (the last year for which complete figures are available). Manufacturing accounted for 25 percent of the GDP, with light industrial goods such as textiles, clothing, clocks, and electronic goods predominating. Hong Kong has a growing role as a provider of sophisticated commercial, financial, and managerial services to China and is the headquarters for many foreign corporations doing business with China. Its major imports are raw materials, consumer goods, foodstuffs, and fuels.

#### PRINCIPAL TRADING PARTNERS

Hong Kong is the world's 12th largest international trader, and in 1985 total trade represented 176 percent of the GDP. Its foreign trade is marked by a large volume of trade with a few partners and a limited range of exports. Hong Kong's principal trading partners are (in order) China, the United States, and Japan. It has a large trade surplus with the United States, a large trade deficit with Japan, and a small trade surplus with China. The major foreign investors in Hong Kong are the United States, Japan, China, and the United Kingdom. The Hong Kong Government is urging businesses to diversify their range of export products and export markets and is promoting sales to the Federal



Republic of Germany.

#### MAJOR ECONOMIC PROBLEMS

Hong Kong's economic performance depends primarily on world trade conditions and the decisions of its much larger major trading partners. The most immediate threat to Hong Kong's economy comes from protectionist measures in the United States, directed at Hong Kong's textiles and clothing exports, and from calls by United States officials for Hong Kong to revalue its currency upward. In 1987 Hong Kong, with its currency still pegged to the US dollar, will face inflationary pressures as it pays more for its imports of raw materials, oil, and finished goods from Japan. In the medium term of 5 to 10 years, Hong Kong's generally unsophisticated light industry will find its export markets threatened by cheaper products from developing and other newly industrializing countries (NICs). Hong Kong's long term economic prospects are strongly influenced by the agreement between China and Britain for Hong Kong to revert to China on 1 July 1997. Much investment in Hong Kong is short term, and wealthy residents and the professional middle class are widely reported to be preparing to move abroad before 1997. Business confidence in Hong Kong now depends primarily on local perceptions of the intentions of China's leaders, and there are widespread fears both of changes in China's leadership and economic policies and of the possibility that China will not abide by the agreement to maintain Hong Kong's capitalist economic structure for 50 years after 1997.

#### ECONOMIC IMPORTANCE TO THE UNITED STATES

In 1986 Hong Kong was the United States' tenth largest trading partner. The United States had a trade deficit with Hong Kong of \$6.5 billion and a direct investment of some \$6 billion--representing 54 percent of all foreign investment in Hong Kong. The United States is the largest foreign investor in Hong Kong's industry, with investment concentrated in electronics and computers. Eight hundred US corporations are based in Hong Kong, and over 16,000 US citizens reside there. In 1986 Hong Kong purchased \$3 billion worth of US consumer goods and agricultural produce and provided the United States with what is estimated to be a substantial amount of capital, as wealthy Hong Kong residents hedged against the consequences of reversion to China by investing in property and banks in the United States.

#### VERY LIMITED SPENDING ON DEFENSE

Hong Kong pays 75 percent of the cost of maintaining the British garrison of 8,800 military plus 3,200 civilian personnel. The total cost to the Hong Kong Government is about US\$250 million per year, about 4 percent of government expenditures or 0.6 percent of GDP. This sum is to be increased by 3.4 percent in 1987.